BRIEFING

What's Happening in Pensions

Issue 111 – September 2024

Travers Smith Pensions Sector Group

#TraversSmithPensions

In this issue:

Reminder - default SIP deadline: Schemes with DC benefits that have not updated their default arrangement SIP since before October 2023 need to act by 1 October 2024 to include content about their policy on illiquid investments.

TPR DB funding code of practice: The Pensions Regulator's new DB funding code of practice has been laid before Parliament. Subject to approval, it is expected to take effect in early November.

Lifetime allowance abolition: Regulations should be laid very soon to correct issues with the legislation abolishing the lifetime allowance and introducing the new allowances.

Virgin Media case – industry / DWP discussions: It appears that there will be no further appeal in the *Virgin Media* case. Industry groups are discussing with the Government the possibility of regulations to validate amendments that were made without the requisite confirmation having been given (or where it cannot be found).

Value for money consultation: The FCA is consulting on a proposed Value for Money Framework for significant default arrangements in contract-based DC pension arrangements. The resulting regime is intended to be mirrored by the Government as closely as possible for trust-based DC and regulated for them by the Pensions Regulator.

TPR ESG report: The Pensions Regulator has published its Market Oversight: ESG Report, which sets out findings from its review of how trustees are complying with the ESG disclosure duties in their statements of investment principles and implementation statements.

Pensions Review: The Government has published terms of reference and a call for evidence for Phase One of its Pensions Review, covering investment and value for members of DC arrangements and the consolidation and governance of Local Government Pension Scheme funds.

TPR superfunds guidance: The Pensions Regulator has updated its superfunds guidance. The most notable change will allow the release of capital from a superfund or capital backed arrangement up to twice a year, rather than only when benefits are bought out.

Pensions Ombudsman corporate plan: The Pensions Ombudsman's corporate plan for 2024/25 has been published, setting out their current priorities.

PENSIONS RADAR: You may also be interested in the latest edition of Pensions Radar, our quarterly listing of expected future changes in the UK law affecting work-based pension schemes.

SUSTAINABILITY MATERIALS: Our Sustainable finance and Investment Hub includes a section on ESG and sustainable finance issues for pension schemes and their sponsors.

Reminder - default SIP deadline

Regulations made in 2023 require schemes that provide DC benefits (other than just from additional voluntary contributions) to disclose and explain their policy on illiquid investments in the statement of investment principles (SIP) for their default arrangement(s). This applies whether or not the default arrangement includes any such investments. This had to be done the next time a default arrangement SIP was revised after 1 October 2023 or (if later) by 1 October 2024.

Schemes with DC benefits that have not updated their default arrangement SIP since before October 2023 need to take action by 1 October 2024. Pensions Regulator guidance and Government statutory guidance explain and elaborate on what is required but please get in touch with your usual Travers Smith contact as soon as possible if you need any assistance with this.

TPR DB funding code of practice

The Pensions Regulator's DB funding code of practice was laid before Parliament on 29 July 2024, where it remains for 40 sitting days before taking effect (in the absence of any objections). Due to Parliament's summer and conference recesses, it will not be in force until after the legislation (see WHiP Issue 108) takes effect, which is for valuations with effective dates on and after 22 September 2024: that would seem to mean early November. The Regulator said that it will be communicating with schemes that are directly affected by the gap.

The Regulator has also published details of the finalised fast-track parameters and a consultation response on those and other aspects of its new regulatory approach. The Regulator estimates that (as at March 2023) 62% of schemes are already within the fast-track parameters and a further 19% could be within them without further cost or changes to their asset allocation. The Regulator will review the parameters at least annually and more comprehensively every three years.

We still await guidance on the regulatory approach, the final template for the statement of strategy, and a consultation on covenant guidance. These are expected in the autumn and (for the covenant consultation) "in due course". Existing guidance will also be reviewed.

We outline below the most significant changes to the code from the consultation draft. Please see our earlier briefing for background on the new regime.

As expected, there are changes to the code from the consultation draft to reflect not only consultation responses but also changes to the final regulations from their consultation version. In particular, there is greater flexibility for schemes to take account of their specific circumstances as regards funding and investment risk, and also help for open schemes.

But there remain concerns that the new regulatory regime may be excessive in the new world of widespread funding basis surpluses and that its focus on member security, including the requirement for highly resilient investment strategies, is not easy to reconcile with the more recent Government policy of encouraging schemes to invest in productive assets to help with economic growth.

Points to note from the final code are as follows:

- 'Significant maturity' now means a weighted mean duration of liabilities of 10 years for DB schemes and 8 years for cash balance schemes. (The consultation proposal was 12 years, so this pushes back the date by which a scheme should be aiming to complete its journey to low dependency.)
- The regulations state that economic assumptions must be set with reference to economic conditions at 31 March 2023. The Regulator says that this means setting economic assumptions based on the economic conditions that applied at 31 March 2023, as if that were the valuation date (and this will be a 'fast-track' requirement). But it recognises that an ambiguity in the regulations would seem to allow a projection of economic conditions to the actual valuation date (and 'bespoke' submissions will be able to take that approach).
- It is now clear that trustees are not required to invest in line with the notional asset allocation in their funding and investment strategy, though in most instances they are expected to be aligned. This applies both when the scheme has reached low dependency and also along the journey plan. The Regulator says: *"The notional investment allocation is used to derive and support actuarial assumptions for funding purposes."*. Any surplus on the low

dependency funding basis does not have to be invested, or even treated as invested, in line with the low dependency investment allocation.

- Following a change in the final regulations, assets do not need to be broadly matched to cashflow: trustees can have a strategy of disinvestment of appropriate assets alongside matched investments.
- There is less prescription around the "highly resilient" test for low dependency investment allocation.
- There is now a principles-based, rather than formulaic, approach for trustees to assess the maximum level of risk that can be supported for their scheme by the employer covenant. A Regulator test will be announced later as an initial trigger for a regulatory risk assessment.
- It is now stated that for the low dependency funding basis, it is not necessary that no further employer contributions will be required under "most reasonably foreseeable circumstances". Trustees now need to be satisfied that the likelihood of requiring further contributions is small and that any that might be required are small relative to the size of the scheme.
- As well as reflecting changes to the regulations regarding open schemes, the final code includes additional flexibilities, including as regards assumptions for future accrual and new members. The content for open schemes is now collated in a new section of the code.
- The covenant content is now clear that assessment of an employer's financial ability to support a scheme relates to the employer's legal obligations to the scheme. Assessment of the period of 'covenant visibility' (relating to employer forecasts), though still important, is no longer explicitly itemised as a specific period for assessment: only the covenant 'reliability period' and 'longevity period' are now specified. And there is now more content on how to assess those periods and how much work is required in various scenarios. But covenant for these purposes is still different from its definition for anti-avoidance purposes: for example, it does not consider an employer's actual unencumbered assets – only cashflows and contingent assets: hopefully there will be content on this in the forthcoming guidance.
- The content on recovery plans and 'reasonable affordability' has been altered. The Regulator still considers it an overriding principle that deficits must be recovered as soon as the employer can reasonably afford and this should be assessed on a "year-by-year basis", presumably meaning annually. But the employer's sustainable growth is now listed first in the principles that the trustees should consider. Some investment outperformance can be assumed when formulating recovery plans (as can post-valuation experience) but the code includes restrictions on this.
- The code includes content on the information to be included in the statement of strategy. Reassuringly, the Regulator says that the information will be treated as confidential.
- There is added content on proportionality, i.e. the level of analysis and explanation required in various areas based in each case on various relevant factors.
- The code is now made up of modules, which would seem to fit conveniently with the Regulator's general code.

Lifetime allowance abolition

HMRC's Pension Schemes Newsletter 161 mentions a private consultation on draft regulations to correct defects in the legislation around the abolition of the lifetime allowance and introduction of the new allowances. We have contributed to industry group responses to this consultation.

The newsletter says that the Government plans to introduce the regulations as soon as the parliamentary timetable permits after the summer recess. Parliament returned from summer recess on 2 September 2024 but there is a party conference recess from 12 September to 7 October.

Virgin Media case – industry / DWP discussions

We undersatand that the Court of Appeal's judgment in the *Virgin Media* case will not be appealed further.

As previously reported, the Government has power in legislation to validate amendments in relation to section 9(2B) rights which, following the *Virgin Media* case, should have had a section 37 confirmation but did not (or if they did then it cannot be found). The Association of Consulting Actuaries, Association of Pension Lawyers and Society of Pension Professionals have informed their members that an industry group is in discussions with the Department for Work and Pensions, having asked the Department to make such regulations to resolve issues and avoid windfalls.

For background, see our alert on the Court of Appeal decision and our Q&As briefing, which we have updated to include more content on questions around reviewing historic deeds of amendment for potential issues.

Value for money consultation

The FCA is consulting on a proposed Value for Money (VFM) Framework for significant default arrangements in contract-based DC pension arrangements. The resulting regime is intended to be mirrored by the Government as closely as possible for trust-based DC schemes (including employers' private schemes and master trusts) and regulated for them by the Pensions Regulator. The Pensions Regulator has therefore encouraged trustees and the wider pensions industry to respond to the FCA's consultation. Changes required to primary legislation will be picked up in the forthcoming Pension Schemes Bill (see WHiP Issue 110).

The consultation closes on 17 October 2024. There is no timescale given for implementation of the new regime.

The FCA proposes a red/amber/green traffic light system for categorising arrangements:

- Those rated green provide VFM.
- Those rated amber require a plan for earning a green rating, normally within two years, and would have to stop accepting new employers until they are rated green.
- Those rated red should be calling it a day and transferring members to a green arrangement.

In amber and red cases, all relevant employers need to be notified that the scheme is 'not-VFM'.

The consultation paper sets out various proposed metrics for assessing the VFM (or otherwise) that an arrangement offers, in three categories:

- investment performance;
- costs and charges; and
- quality of services.

The proposed metrics are numerous and prescriptive. Gathering the data required for the VFM assessment is likely to involve significant work for schemes each year.

Providers and trustees will be required to publish framework data on how they measure up against the various metrics. They will then use this data to compare their own scheme with the data published by other suitable comparator schemes. Annual reports will need to set out information about the VFM review and the comparisons, including the red/amber/green rating for each default arrangement.

The consultation also covers proposals to require schemes to disclose asset allocation percentages for their default arrangements. This is based on the existing requirements for occupational pension schemes but there will be more breakdowns required, including as to the percentage holdings of UK/non-UK and listed/unlisted assets.

TPR ESG report

The Pensions Regulator has published its Market Oversight: ESG Report, which sets out findings from its review of how trustees are complying with the ESG disclosure duties in their statements of investment principles (SIPs) and implementation statements (ISs).

The Regulator reviewed approximately 3,500 scheme returns to check that they had provided a link to their publicly accessible SIP and IS disclosures. Machine reading was used to review the disclosures of about 375 schemes and the Regulator looked "in-depth" at around 50.

1% of schemes had not provided web links to the Regulator and 2% of the links provided could not be accessed by Regulator staff. The schemes in question have been asked to provide appropriate links.

Less satisfactory to the Regulator was the quality of disclosures from the sample of schemes it looked at in detail. In particular:

- Too many smaller schemes opted for minimum compliance. The Regulator says that if trustees do not feel competent to manage ESG risks effectively, they should consider consolidation.
- The Regulator wants to see more evidence of trustee oversight where management of financially material risks, engagement and voting has been delegated to an investment manager.
- Where assets are invested in pooled funds, trustees still need to provide appropriate detail in their reporting and show that they are influencing and taking ownership of ESG considerations.

Earlier this year, the Regulator also reviewed climate governance reports in schemes' annual reports (see WHiP Issue 108).

Pensions Review

The Government has published short terms of reference for Phase One of its Pensions Review.

This makes it clear that the review is only looking at DC pensions, plus the Local Government Pension Scheme (LGPS). Initiatives concerning DB schemes are being progressed separately.

Phase One will consider:

- How to drive scale and consolidation of DC workplace schemes
- How to tackle fragmentation and inefficiency in the LGPS through consolidation and improved governance
- "The structure of the pensions ecosystem" (whatever that means) and focusing on value rather than cost
- Encouraging further pension investment into UK assets

Initial Phase One findings will be published "later this year and ahead of the introduction of the Pension Schemes Bill".

Subsequently, a call for evidence (closing on 25 September 2024) asks for input from stakeholders on questions around scale and consolidation, costs versus value, and investing in the UK.

Phase Two (terms of reference to be published later) will, "alongside investment", consider further steps to improve pension outcomes, including adequacy. This will begin "later this year".

TPR superfunds guidance

The Pensions Regulator has updated its superfunds (DB consolidator scheme) guidance.

The most notable change will allow the release of capital from a superfund or capital backed arrangement up to twice a year, rather than (until now) only when benefits are bought out. This is subject to capital adequacy safeguards. The Regulator says that this supports innovation while continuing to protect scheme members. Further safeguards have also been introduced to ensure that a superfund does not pick favourable dates (when markets are high) to release capital and that there is a formal governance process. The Pensions Regulator will have to be notified in advance.

Other changes include the following:

- On the transfer of a new pension scheme to a superfund, it will no longer be necessary for fresh capital to be provided at a level which, together with value obtained through the transaction, would satisfy capital requirements if that pension scheme were considered in isolation. This 'standalone test' is dispensed with so long as the superfund in aggregate is funded above the level at which capital can be released.
- The standard capital adequacy requirements can now be relaxed where a pension scheme’s sponsoring employer becomes insolvent and the scheme is unable to afford a full buy-out, or to enter a superfund or capital backed

arrangement on full capital adequacy terms. In these circumstances, trustees would need be confident that the transaction is in members' best interests and that, even on the lower capital adequacy basis, the level of benefits members might receive would represent a material improvement compared with buying out with an insurer on PPF+ benefit levels.

Pensions Ombudsman corporate plan

The Pensions Ombudsman's (TPO) corporate plan for 2024/25 has been published.

Demand for TPO's services has outstripped its increased capacity and there remain "unacceptably long waiting times", including an average 12 month wait for a new complaint to be allocated for early resolution or formal adjudication. The 2023 cyber-attack clearly made things worse. As previously reported (see WHiP Issue 109), an operating model review has been considering how to improve TPO's service. An arm's-length review will also be conducted shortly.

Under the new corporate plan, TPO's current priorities are:

- *"Make changes to its processes that reduce waiting times.*
- *Deliver a reduction in the number of older, complex cases from its historical caseload.*
- *Improve signposting and pre-application journey, with more self-service information, so that the 'right' complaints come to TPO.*
- *Secure long-term funding of the Pensions Dishonesty Unit, to ensure it can continue its valuable work.*
- *Expand and build TPO's specialist pensions expertise.*
- *Review current systems to ensure TPO has a clear view of requirements to deliver further efficiencies and meet the projected increase in demand."*

FOR FURTHER INFORMATION, PLEASE CONTACT

Susie Daykin
Partner, Head of Pensions
susie.daykin@traverssmith.com
+44 (0)20 7295 3247

Daniel Gerring
Partner
daniel.gerring@traverssmith.com
+44 (0)20 7295 3341

Niamh Hamlyn
Partner
niamh.hamlyn@traverssmith.com
+44 (0)20 7295 3287

David James
Partner
david.james@traverssmith.com
+44 (0)20 7295 3087

Chris Widdison
Partner
chris.widdison@traverssmith.com
+44 (0)20 7295 3604

Nick White
Knowledge Counsel
nick.white@traverssmith.com
+44 (0)20 7295 3472

10 Snow Hill | London EC1A 2AL | T: +44 (0)20 7295 3000 | F: +44 (0)20 7295 3500 | www.traverssmith.com